IN THE

Supreme Court of the United States

OCTOBER TERM, 1960

No. 94

WM. G. LEWIS, Trustee,
Petitioner,
vs.
MANUFACTURERS NATIONAL BANK OF DETROIT,
Respondent

BRIEF FOR PETITIONER

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REPORTED OPINION

The following reported opinion was rendered in the within cause: *In re Todor A. Alikasovich, d/b/a Miami Cleaners & Tailors* (6 Cir., 1960), 275 F. 2d 454 (R. 12). Opinions of Referee and District Court are at R. 2 and R. 5, respectively.

JURISDICTION

Jurisdiction is conferred on this Court by §24c of the Bankruptcy Act, 11 USC §47c; and by 28 USC §1254. Petition for writ of certiorari was filed within applicable 90-day period and order granting said wit was issued by this Court on June 27, 1960 (R. 18).

STATUTES INVOLVED

1. The Constitution of the United States, Art. I, Sec. 8, cl. 4:

> "The Congress shall have Power • • • To establish • • • uniform laws on the subject of Bankruptcies throughout the United States."

2. Bankruptcy Act, Sec. 70c; 11 USC Sec. 110c:

> "The Trustee, as to all property, whether or not coming into possession or control of the court, upon which a creditor of the bankrupt could have obtained a lien by legal or equitable proceedings at the date of bankruptcy, shall be deemed vested as of such date with all the rights, remedies, and powers of a creditor then holding a lien thereon by such proceedings, whether or not such a creditor actually exists."

3. Bankruptcy Act §70e; 11 USC §110e:

> "(1) A transfer made or suffered or obligation incurred by a debtor adjudged a bankrupt under this Act which, under any Federal or State law applicable thereto, is fraudulent as against or voidable for any other reason by any creditor of the debtor, having a claim provable under this Act, shall be null and void as against the Trustee of such debtor.

"(2) All property of the debtor affected by any such transfer shall be and remain a part of his assets and estate, discharged and released from such transfer and shall pass to, and every such transfer or obligation shall be avoided by, the Trustee for the benefit of the estate: Provided, however, That the Court may on due notice order such transfer or obligation to be preserved for the benefit of the estate and in such event the Trustee shall succeed to and may enforce the rights of such transferee or obligee. The Trustee shall reclaim and recover such property or collect its value from and avoid such transfer or obligation against whoever may hold or have received it, except a person as to whom the transfer or obligation specified in paragraph (4) of this subdivision e is valid under applicable Federal or State laws.

"(3) For the purpose of such recovery or of the avoidance of such transfer or obligation, where plenary proceedings are necessary, any State court which would have had jurisdiction if bankruptcy had not intervened and any court of bankruptcy shall have concurrent jurisdiction."

4. Michigan Compiled Laws 1948, §566.140, as amended by Public Acts of 1957, Act 233; MSA §26.929:

"Every mortgage or conveyance intended to operate as a mortgage of goods and chattels which shall hereafter be made which shall not be accompanied by an immediate delivery and followed by an actual and continued change of possession of the things mortgaged, shall be absolutely void as against the creditors of the mortgagor, and as against subsequent purchasers or mortgagees in good faith, unless the mortgage or a true copy thereof shall be filed in the office of the register of deeds of the county where the goods or chattels are located, and also where the mortgagor resides, except when the mortgagor is a non-resident of the state, when the

mortgage or a true copy thereof shall be filed in the office of the register of deeds of the county in which the property is located: Provided that no purchase money mortgage shall be void as against the creditors of the mortgagor if filed within 14 days from the date of the execution of such mortgage."[1]

QUESTION PRESENTED FOR REVIEW

Is a belatedly recorded chattel mortgage void as against a Trustee in Bankruptcy under §70c of the Bankruptcy Act without proof of the existence of an actual creditor who could void the mortgage, when state law provides that such mortgage is void against a simple contract creditor without a lien who extends credit in the interim between the execution and the recording of the mortgage?

STATEMENT OF THE CASE

This case involves the validity of a belatedly recorded chattel mortgage on an automobile as against the claims of the Trustee in bankruptcy of the mortgagor.

Prior to bankruptcy, the bankrupt had borrowed money from Manufacturers National Bank of Detroit, Michigan. To evidence the loan and secure its payment, on Novem-

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[1] The last proviso was added by Act 233 of 1957 and replaced the proviso which had been added by Act 153 of 1956. See *Hertzberg v. Associates Discount Corporation* (6 Cir. 1959) 272 F. 2d 6; cert. den. April 18, 1960. Act 233, in turn, has been replaced by Public Acts of 1959 No. 110 which provides that *any* mortgage is valid as against creditors if recorded within 10 days after its execution. This amendment has no effect on the problem presented herein. Under the 1959 Act, the problem presented by this case will still occur if the mortgage is recorded more than 10 days after its execution.

ber 4, 1957 he executed and delivered to the bank a promissory note and chattel mortgage on his 1953 Pontiac automobile. The chattel mortgage was filed by the bank with the Wayne County Register of Deeds on November 8, 1957. There was no evidence that any creditor had extended credit between November 4 and November 8, 1957 (R. 13).

About five months later, namely, April 18, 1958 the borrower filed a voluntary petition in bankruptcy in the District Court upon which an adjudication in Bankruptcy was duly entered (R. 13).

The mortgage in question was admittedly not a purchase money mortgage, and the 14 day grace period allowed by Act 233 of 1957 did not apply. Since the mortgage was not recorded immediately, the Referee in Bankruptcy held that it was void as against the Trustee in Bankruptcy under §70c of the Bankruptcy Act as interpreted by *Constance v. Harvey* (2 Cir., 1954), 215 F. 2d 571 (R. 13-14).

Under that decision, the Trustee, by virtue of §70c of the Bankruptcy Act, is given the rights of a hypothetical creditor who extended credit in the interim between the execution and the recording of the mortgage and who, on the date of bankruptcy, obtained a lien on the property of the bankrupt.

The District Court reversed, and the judgment of the District Court was affirmed by the Court of Appeals for the 6th Circuit on March 7, 1960.

SUMMARY OF ARGUMENT

(1) The powers granted to a Trustee by the Bankruptcy Act are not derived from the bankrupt or from creditors of the bankrupt, but are independent powers which are conferred by Congress. There are many instances in the Bankruptcy Act where a Trustee's power is greater than the power of the bankrupt or of any actual creditor of the bankrupt.

(2) By §70e of the Bankruptcy Act, Congress gives to a Trustee in Bankruptcy the powers of a hypothetical ideal creditor who, on the date of bankruptcy, acquired a lien on the property of the bankrupt. Included in said rights are the rights of a simple contract creditor without any lien who extended credit in the interim between the execution and the recording of a belatedly recorded mortgage.

(3) These powers of the Trustee derive from former §47a (2) of the Bankruptcy Act passed in 1910. Subsequent amendments have only clarified the position of the trustee.

ARGUMENT

I.

Six years ago the 2d Circuit, in *Constance v. Harvey* (2 Cir., 1954), 215 F. 2d 571; cert. den. 348 U. S. 913, held that where state law provides that a belatedly recorded chattel mortgage is void as against an interim contract creditor of the bankrupt, a Trustee, with his status as a creditor with a lien, could void the mortgage, even though it could not have been voided by any existing creditor of the bankrupt. The 6th Circuit, in the instant case, reached a directly contrary result. It is our position that the 2d

Circuit's application of the clear language of §70e was correct, and that the 6th Circuit was in error.

Contrary to the interpretation of the 6th Circuit, the Bankruptcy Act confers powers on a Trustee in Bankruptcy which are wholly independent of the powers of any existing creditor of the bankrupt. These are not derived powers nor are they powers to which the Trustee is subrogated. They are powers conferred on him by Congress exercising its paramount and exclusive power to pass a uniform law of bankruptcy. Const. Art. 1, §8, cl 4. The position of the petitioner herein is that the decision in *Constance v. Harvey,* (2 Cir. 1954), 215 F. 2d 571, cert. den. 348 U. S. 913, is merely another instance where the Trustee's powers are found by reference to the language of the Bankruptcy Act, and not by reference to the rights of creditors. Other examples may be listed as follows:

(1) §11 of the Bankruptcy Act, 11 U.S.C. §29, allows a Trustee two years from the date of the adjudication to institute legal proceedings, without regard to the statute of limitations applicable to creditors under state law.

(2) §60 of the Bankruptcy Act, 11 U.S.C. §96, gives the Trustee the right to recover a preference made by the bankrupt within four months prior to the date of bankruptcy. Many states, including Michigan, do not give creditors such a right under any conditions. See *Corn Exchange National Bank v. Klauder, infra,* where a transaction perfected as to all existing parties prior to bankruptcy was held to have been hypothetically perfected immediately before bankruptcy and, therefore, a voidable preference.

(3) §67a of the Bankruptcy Act, 11 U.S.C. §107a, gives the Trustee the power to invalidate judicial liens obtained within four months prior to the date of bankruptcy at a

time when the bankrupt was insolvent. We are aware of no state law which gives creditors similar rights.

(4) . §67d of the Act, 11 U.S.C. §107d, sets up a federal version of the Uniform Fraudulent Conveyance Act and gives the Trustee a right to void a fraudulent conveyance as defined in that section, without regard to whether or not an existing creditor could have voided it under state law.

(5) . Even §70e of the Act, 11 U.S.C. 110e, which requires the so-called "flesh and blood" creditor, gives the Trustee powers which are greatly in excess of those which the existing creditor has under state law. Under the decisions in *Moore v. Bay* (1931), 284 U.S. 4; *General Motors Acceptance Corporation v. Coller* (6 Cir. 1939), 106 F. 2d 584, cert. den. 309 U.S. 682, and *Miller v. Sulmeyer* (9 Cir. 1959), 263 F. 2d 513, cert. den. Oct. 12, 1959, the Trustee, if he finds a "flesh and blood" creditor as to whom a transaction is partially void, uses the powers of this "flesh and blood" creditor to void the entire transaction without regard to the extent of the powers of the actual creditor. Although *Moore v. Bay* has been the law for almost thirty years, some courts still find it difficult to apply it where no actual creditor of the bankrupt could void the entire transaction. Not only has it been the law for thirty years, but Congress, by passage of the Chandler Act in 1938 (Act June 22, 1938, 52 Stat. 840), adopted the ruling in §70e (2) by stating that *all* property affected by a fraudulent transfer passes to a Trustee free and clear of the claims of the transferee.

The foregoing are the outstanding examples of instances where the powers of a Trustee are not measured by the powers of existing creditors. The Trustee's powers are not derived from the rights of existing creditors. See *In*

re Kranz Candy Co. (7 Cir. 1954), 214 F. 2d 588, and *In re Consorto Construction Co., Inc.* (3 Cir. 1954), 212 F. 2d 676, and *Miller v. Sulmeyer, supra.*

It is clear that the Trustee has powers to void certain transactions of which no creditor could have complained. Yet, the Court of Appeals in the instant case held that:

> "The Trustee in Bankruptcy is not an innocent purchaser for value. He takes title to the bankrupt's property subject to all liens, claims and equities existing thereon. In fact, the Trustee, standing in the position of a creditor, holds about the lowest form of security."

R. 16, citations omitted.

This holding is contrary to the basic policy of the Bankruptcy Act, and to its interpretations. Many sections of the Act grant substantive powers to the Trustee. Under §70c, the Trustee stands full-panoplied with all of the powers of a creditor of the bankrupt who has obtained a lien on all the property of the bankrupt, whether or not such a creditor actually exists.

II.

The language of §70c is clear:

> "The Trustee, as to all property, whether or not coming into possession or control of the court, upon which a creditor of the bankrupt could have obtained a lien by legal or equitable proceedings at the date of bankruptcy, shall be deemed vested as of such date with all the rights, remedies, and powers of a creditor then holding a lien thereon by such proceedings, whether or not such a creditor actually exists."

It seemed clear enough to Judges Chase, Hincks and (Justice) Harlan in *Constance*. It was equally clear to Judges Clark, Medina and Waterman in *Conti v. Volper* (2 Cir. 1956), 229 F. 2d 317, where both sides, in their briefs, urged the 2d Circuit to overrule *Constance;* but the Court held that the clear language of §70c could not be disregarded.

An equally clear provision of the Bankruptcy Act was held by this Court to create a voidable preference against strong assertions that such a decision would result in the destruction of non-notification account receivable financing and despite the fact that the transaction was not voidable by existing creditors. *Corn Exchange National Bank and Trust Co. v. Klauder* (1943), 318 U. S. 434, which is discussed in more detail below.

The Court of Appeals in the instant case chose to base its opinion to a certain extent, on legislative history. This Court has held that "there is no need to refer to the legislative history where statutory language is clear." *Ex parte Collet* (1949), 337 U.S. 55, 61. The legislative history used by the Court of Appeals was a House Report of the 86th Congress in 1959, reporting on HR 7242, which purports to change the results required by *Constance*. Certainly such a report in 1959 can be of no assistance in determining the legislative intent of Congress in passing the Bankruptcy Act of 1910, the Chandler Act of 1938, or the amendments to §70c in 1950 and 1952.

In *Constance*, the 2d Circuit said:

> "Since an existing creditor, without notice of the chattel mortgage, could have obtained a lien at the time of the filing of the petition in bankruptcy, and since under §70c of the Bankruptcy Act the Trustee was entitled to be put in the position of an 'ideal' hypothetical creditor—we think his position must

prevail over that of the mortgagor-appellant." (Citation omitted.)

In *Conti v. Volper, supra,* three different members of that Court said:

"* * * It is difficult to see how such plain language could be disregarded."

We need not go beyond the clear language of 70c. The section gives the Trustee the rights of a hypothetical ideal creditor who has obtained a lien on the date of bankruptcy, whether or not such a creditor actually exists.

III.

Given a belatedly recorded mortgage, the States have divided into two main groups in determining which creditors of the mortgagor can void the mortgage. In some states, the mortgage is void as to a simple contract creditor, usually called an interim creditor, who extends credit in the interim between execution of the mortgage and its recording,[2] without regard whether he obtains a lien before recording, or after recording, or not at all. See *Ransom & Randolph Co. v. Moore* (1935) 272 Mich. 31.

In other states, the mortgage is void only as to a creditor who fastens a lien on the property in the interim between execution and recording, usually without regard to when the lien creditor extended his credit.

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[2] In those states where the mortgage is void as to all creditors, or to creditors after execution (subsequent creditors), or to creditors before recording (antecedent creditors), the mortgage will necessarily be void as to an interim creditor, *inter alia.* In Michigan, only the interim creditor can void the mortgage.

In both groups of States, §70c voids the mortgage where it has not been recorded prior to bankruptcy. But where the mortgage has been recorded prior to bankruptcy, §70c voids the mortgage only in those States where an interim contract creditor could have voided it. Since the Trustee's lien arises on the date of bankruptcy, it has no effect on a mortgage recorded before bankruptcy in a State which requires an interim lien creditor. Thus, the Trustee's lien does not "relate back", and *Constance* itself recognizes this important distinction.

The Court of Appeals in the instant case failed to make that distinction. It relied on *Holt v. Crucible Steel Co.*, (1912), 224 U.S. 262, and *In re American Textile Printers Co.* (D.C. N.J. 1957), 152 F. Supp. 901. The former case properly held that a mortgage was valid against a Trustee when it had been recorded prior to bankruptcy and when Kentucky law required the existence of an actual creditor who had actually obtained a lien in the interim between execution and recording. The latter case was cited by the Court of Appeals as having refused to follow *Constance*. This is a misreading of the case. *American Textile* properly distinguished itself from *Constance* on the ground that New Jersey law required the existence of an *interim lien* creditor. With this distinction in mind, it becomes obvious that *Constance* does not, as its critics have said, make of §70e a superfluity. §70e is still required where the state law requires an interim *lien* creditor. In those states, which include those adopting the Uniform Commercial Code, (See 1957 Text, §9-301(1)(b) and (3)), a belatedly recorded mortgage which is perfected before bankruptcy cannot be voided by §70c. In order to void such a mortgage the Trustee will still have to find a "flesh and blood" interim lien creditor and apply §70e. There are many states where §70e is still required, and it

is even required in Michigan in order to void a tardily recorded real estate mortgage. See CL '48 §623.83, Mich. Stat. Anno. §27.1582.

Despite the attacks of its critics, *Constance* does not make §70e superfluous. As always, each section has its advantages and disadvantages, and each has its own applications. They complement each other and, taken together, evidence a strong Congressional purpose to give the Trustee powers exceeding those of actual creditors.

IV.

Michigan law relating to the recording of chattel mortgages is clear and was followed in the Court below. Michigan has (before 1960) required that a chattel mortgage must be recorded immediately and that it is void as to an interim contract creditor. Although the statute has been amended three times in obvious attempts to avoid the results of *Constance*, the law applicable to the instant chattel mortgage required that the mortgage be recorded immediately. *Ransom & Randolph Co. v. Moore* (1935), 272 Mich. 31. *General Motors Acceptance Corporation v. Coller* (6 Cir. 1939), 106 F. 2d 584, cert. den. 309 U.S. 682; *In re Tobias* (WD Mich. 1957), 150 F. Supp. 288. Opinion below, R. 14.

The 4-day delay in the instant case in recording is not an immediate recording. The application of *Constance* to this situation means that the failure of the mortgagee to comply with the state law renders his mortgage void under the clear language of §70c.

Two decisions applying Michigan law serve to point up the rights of a Trustee under §70c. The first decision involved a real estate mortgage which had not been recorded on the date of bankruptcy. Since the Trustee under §70c

is armed with the rights of a levying creditor on the date of bankruptcy, and since on that date the real estate mortgage had not been recorded, and since Michigan law gives a levying creditor priority in such a situation, it might seem quite clear that §70c grants the Trustee priority. However, the problem is not that simple. Michigan law not only requires a levy, but requires that the levying creditor, without notice of the existence of the mortgage, take the affirmative act of recording a notice of his levy before he obtains such knowledge. CL '48 §623.83, Mich. Stat. Anno. §27.1582. In *Ashbaugh v. Becker* (ED Mich. 1936), 14 F. Supp. 465, it was held that the Trustee, as an ideal hypothetical creditor, was a hypothetical creditor without notice and was a hypothetical creditor who had recorded notice of levy, even though neither the Trustee nor an existing creditor had actually done so. For a similar decision, see *Sampsell v. Straub* (9 Cir. 1951), 194 F. 2d 228.

The second decision was *In re Urban* (7 Cir. 1943), 136 F. 2d 296. Although this case was decided by the 7th Circuit, it involved a Michigan chattel mortgage. Under Michigan law, a creditor who extends credit prior to the execution of the mortgage but who obtains a lien in the interim between the execution of a mortgage and its recording, is probably not entitled to priority over the mortgagee. See *Ransom & Randolph Co. v. Moore, supra.* In the *Urban* case the mortgage had not been recorded on the date of bankruptcy. The mortgagee argued that although the Trustee had a lien on that date, there was no showing that he *or any existing creditor* had extended credit in the interim between the execution of the mortgage and the date of bankruptcy. His hypothetical lien could have arisen as a result of credit hypothetically extended prior to the date of the mortgage. The Court, however, held that

the Trustee, as the ideal hypothetical creditor, as a member of the most favored class of creditors, took priority over the mortgagee.

Here again are two situations where the Trustee's rights were not measured by the rights of an existing creditor but were measured solely by reference to the clear language of §70c. And there has been no criticism of these cases, despite the fact that the mortgages in question may have been perfectly valid as against existing creditors. The Trustee's powers under §70c exist without regard to the powers of the bankrupt's creditors.

V.

Constance does not stand alone. It follows other decisions in defining the powers of a Trustee under §70c.

Perhaps the best description of the powers conferred upon the Trustee by §70c is contained in a case decided in 1911. *In re Calhoun Supply Co.* (DC Ala. 1911) 189 F. 537. This case was one of the first cases to follow the passage of §47a(2) in 1910, which was the predecessor to present §70c. It must be noted that the words "whether or not such a creditor actually exists" were not in the Act in 1910. The problem arose because Alabama law said that an unrecorded conditional sales contract was void as to judgment creditors. Under Alabama law, such a contract was void as to a creditor who obtained a judgment in the interim between execution and recording, without regard to when he extended credit, and without regard to when he obtained a lien on the property. See *McKay v. Trusco Finance Co. v. Montgomery, Alabama, infra.* The argument was made in the Calhoun case that unless the rights of a lien creditor necessarily included a judgment creditor, the contract was valid. The Court held that the

Trustee had the rights of a judgment creditor. It is not merely this holding of the court which is important, it is the reasoning which was used by the court at a time when the section of the Bankruptcy Act did not specifically state that the trustee has the rights of a lien creditor "whether or not such a creditor actually exists". The reasoning of the court was given as follows:

> "The purpose of Congress was to embrace within these words every class of creditors with liens by legal or equitable proceedings favored by the varying registration laws of each of the states. The registration laws of some states include but one of many classes of such creditors. In that case the purpose of Congress is not to be frustrated as to the included class because other classes included in the amendment were not included also in the registration act of that particular state.
>
> "The breadth of language was used for the purpose of gathering in all classes protected by all local registration acts, and this purpose would be defeated by the construction contended for by the petitioner. 539.
>
> "The test is whether there exists a class properly within the language of the amendment and that of the Alabama registration act. It is conceded that a judgment creditor holding a lien by execution is such a class. The trustee, therefore, is vested with the right by the amendment and the registration act of that class to avoid unrecorded conditional sales." 540.

The importance of the decision lies in the court's use of the word "class". If there is a class of protected creditors, then the trustee has the rights of a member of that class who has levied on the property on the date of bankruptcy whether or not such a creditor exists.

Another line of reasoning has been used which results in precisely the same answer. In *Sampsell v. Straub* (9 Cir. 1951) 194 F. 2d 228; cert. den. 343 U.S. 927, the problem was the priority of the trustee's rights over a tardily recorded homestead exemption. Under the peculiarities of California law, an attachment or execution creditor could not have prevailed against the homestead rights of the bankrupt. However, under California law there is a "type of creditor" who would be superior to the homestead rights: a judgment creditor who had voluntarily recorded a notice of his judgment. In a previous decision reported at 189 F. 2d 379, the court had held that the trustee was not such a creditor. The rights of such a creditor do not arise from mere judicial proceedings. They arise from a voluntary act of a creditor in recording notice of his judgment. Since the trustee did not do so, he was not entitled to such rights. However, in this rehearing the Court reversed itself and held that the Trustee must prevail. The Court's reasoning was that there was a possibility that an actual creditor who had obtained a judgment prior to bankruptcy and who had recorded notice of his judgment could have obtained priority. Under §67a of the Bankruptcy Act, this priority could have been voided as to the creditor and preserved by the Trustee for the benefit of the estate if it had been obtained within four months prior to bankruptcy and at a time when the bankrupt was insolvent. No actual creditor had done this. But the Court said that because no actual creditor had done this, the trustee should not be powerless to avoid a tardily recorded homestead exemption." The Court said:

> "To this extent, therefore, the Trustee's powers under 70, sub. c, measured by what a creditor *might have done,* but *for the intervention of bankruptcy,* would be less than his powers measured by what

some creditor actually had done." (At 231; emphasis added.)

Here we have a case decided three years before *Constance v. Harvey* in which the Court stated that the Trustee's powers against a secret lien were to be measured by the powers of any type of creditor who might have prevailed against that lien even though such a creditor never existed. The Trustee was deemed to be in the class of creditors against whom the tardy homestead recordation was void.

At least two cases before *Constance* considered the point in time on which the Trustee hypothetically extended the credit which gave him his hypothetical lien. In both cases the courts held, in effect, that the time of extension of credit was some time after execution of the mortgage. Although, in both cases, the mortgages were not recorded before bankruptcy, both cases are important because they demonstrate that §70c can void a mortgage even where it is not shown that the mortgage is void as to an existing creditor.

The first of these cases is *In re Urban*, discussed *supra*. The second case is *McKay v. Trusco Finance Co. of Montgomery, Alabama*, (5 Cir. 1952) 198 F. 2d 431. In this case, decided two years before *Constance v. Harvey*, the court was even more specific as to the powers granted the trustee. A security device on an automobile had not been recorded on the date of bankruptcy. There was a problem as to whether the security was a conditional sales agreement or a chattel mortgage. The court ultimately held that it made no difference because the trustee's rights were superior to both a conditional sales vendor and to a chattel mortgagee.

Treating the security as a conditional sales contract, the court found that under Alabama law it was void as to "judgment creditors without notice thereof". Under Alabama law, it does not matter when the creditor's debt was contracted and it does not matter when he recovers possession by some form of levy. The controlling factor is that the creditor entered a judgment prior to the recording of the contract, without actual notice thereof. The court held that the trustee with his status as a lien creditor on the date of bankruptcy was a lien creditor who got his lien as a result of a judgment. Under Alabama law, the creditor need not necessarily obtain a lien in the interim. The court held that the fact that the trustee is a lien creditor can in no way detract from his rights as a lessor judgment creditor without a lien. But the court went even further. The court followed the *Sampsell* case, *supra*, and held that the trustee was the most favored creditor under Alabama law which, in the case of a conditional sales contract, is a creditor who obtained a judgment in the interim between the execution of the conditional sales contract and its recording, and who then filed a notice of his judgment, without actual notice of the existence of the contract.

The court then treated the security as a chattel mortgage. The court cited Alabama cases which held that Alabama law protects only creditors who extend credit after execution of the mortgage. It does not protect a pre-existing creditor who obtains a lien or judgment while the mortgage is off record if the claim arose prior to the execution of the mortgage. The facts were that the mortgage was executed on February 7, 1951. The Petition in Bankruptcy was filed three weeks later on March 1, 1951. There was no evidence of any debt contracted by the bankrupt in the period between the date of the mortgage and the

date of bankruptcy. In discussing the problem, the court said:

> "It seems to us however, that, under Section 70, sub. c, of the Bankruptcy Act, the actual existence of such a subsequent creditor is immaterial. It is true that the rights, remedies and powers vested in the trustee by that section are so vested 'as of the date of bankruptcy' and relate to the property of the bankrupt on that date. Nevertheless, the trustee has the status of a creditor then holding a lien thereon by legal or equitable proceedings, whether or not such a creditor exists. *It may be* that in the case of a belated recording prior to bankruptcy the trustee would have to bring himself within the terms of Section 70, sub. e (1) of the Bankruptcy Act (citing Collier). That question is not before us for here the contract was never recorded and possession was not delivered to the creditor until after bankruptcy. Under the facts of this case, Sec. 70, sub. c, is applicable." (Emphasis added.)

The importance of this case is that the 5th Circuit anticipated the decision in *Constance v. Harvey* by two years. In the foregoing language, the court did not specifically decide the problem as to what the result would be if the mortgage had been recorded prior to bankruptcy. However, it is interesting to note that its only citation for its hesitancy was Collier. The importance of the decision lies in the words "the actual existence of such a subsequent creditor is immaterial". The court realized that in order to hold the trustee's lien superior, it had to place him in a class of creditors who had extended credit subsequent to the execution of the mortgage. It is conceivable that the bankrupt had not contracted any debts at all in the three week interval between the date of the mortgage and the date of bankruptcy. Yet the court did not even consider this

possibility. The court's decision was then summarized as follows:

> "The most favored creditor in Alabama would be one who had secured a judgment *upon credit extended subsequent* to the execution of the contract and had either caused execution to be levied upon the automobile, or a certificate of the judgment to be recorded. Sec. 70, sub. c, vests the trustee with all the rights, remedies and powers of such a creditor." (At 435; emphasis added.)

This quotation specifically refers to the Trustee as a creditor who extended credit subsequent to the execution of the contract. And it goes further than that. It also goes on with the powers of a creditor who had obtained a judgment after the execution of the contract and who had levied on the automobile and caused a certificate of judgment to be recorded. This is the most favored creditor in Alabama, and these are the powers of the Trustee.

The cases cited in this section of our brief do not make up an exhaustive list of favorable authority. They are cited to show that *Constance* is not an anomaly, that other courts have reached similar decisions on similar problems, and that the powers of a Trustee are Congressionally defined—not creditor-derived.

VI.

Decisions subsequent to *Constance* are not numerous. The 2nd Circuit repelled an attack on its position in *Conti v. Volper, supra.* The 5th Circuit in *Brookhaven Bank & Trust Co. v. Gwin,* (5 Cir. 1958), 253 F. 2d 17, expressed a dictum which implied that it would follow *Constance,* but later contradicted itself by equally unauthoritative dictum in *Blackford v. Commercial Credit Co.* (5 Cir. 1959), 263 F. 2d 97.

The 9th Circuit in *Miller v. Sulmeyer, supra,* in a §70e case, stated that the mortgage in question could have been voided "by the creditor who wasn't but who might have been." The Court interpreted the Bankruptcy Act as allowing a Trustee to void a creditor's security, even though it is partially valid under state law or even wholly valid under some circumstances, because of the absence in fact of a certain type of creditor.

The New Jersey District in *In re American Textile Printers Co., supra,* properly distinguished *Constance* on the ground that New Jersey law required an interim lien creditor.

The Missouri District in *In re Billings* (1959), 170 F. Supp. 253, did not follow *Constance* and neither did the Court of Appeals in the instant case. Thus, cases subsequent to *Constance* are of no great assistance in determining the question.

VII.

We have anticipated and answered many of the critics of *Constance.* We have shown that the Bankruptcy Act does not limit the powers conferred on a Trustee to the powers held by existing creditors. We have shown that §70e is not superfluous. We have shown that *Constance* does not relate back the lien of the Trustee. We have shown that the preference sections, §60 and §67a, actually give the Trustee retroactive powers, in the sense that he can set aside hypothetically imperfect transactions which were actually perfected long before bankruptcy.

Perhaps the basic problem considered by the Court of Appeals was the fact that Michigan required immediate recording of a chattel mortgage and did not allow a reasonable time or a specified time within which to record. The

Michigan legislature, after two unsuccessful attempts, has finally solved the problem by the passage of Act 110 of Public Acts of 1959, which now allows 10 days for the recording of a chattel mortgage. The future application of *Constance* will thus be limited to cases where the mortgagee has delayed more than 10 days. The Michigan legislature could have completely eliminated the Michigan problem by providing that a belatedly recorded mortgage is void only as to creditors who obtain liens in the interim between execution and recording. Certainly the Michigan legislature was aware of *Constance,* yet it did not take the action necessary to completely insulate mortgagees from its application.

Constance does not create an insuperable practical problem. Even under §70e, a belatedly recorded mortgage is void as against an interim creditor and such a creditor can often be found. Telephones remain connected, electricity is supplied, gas is burned, and milk is delivered. See *In re Tobias* (WD Mich. 1957), 150 F. Supp. 288, where the milkman became an interim creditor; and this unpaid milkman, with his small claim, completely voided a substantial mortgage, although the delay in recording was only 23½ hours.

All of the criticisms of *Constance* were completely answered by this Court in *Corn Exchange National Bank & Trust Co. v. Klauder, supra.* The case arose under §60, which, at that time, provided that the time for determining when a transfer was made for the purpose of determining the four-month preference period was the date on which the transfer became perfected as against *bona fide purchasers* and creditors of the bankrupt. The assignee of accounts receivable, although he took the assignment with the acquiescence of many creditors, did not notify the debtors on the assigned accounts. Under Pennsylvania

law, the failure to notify the debtor meant that the assignment was void as to a subsequent good faith assignee of the accounts who did give such notice. *There was no such assignee in existence.* Nevertheless, this Court held that the clear language of §60 meant that the transaction was not perfected until immediately before bankruptcy because a *hypothetical bona fide* purchaser could have obtained rights superior to the actual assignee.

In this situation, even though the assignment was perfectly valid as against all creditors of the bankrupt, it was voidable by the Trustee under §60.

As stated above, the argument was made that the decision would seriously hamper the business of financing on accounts receivable security. Nevertheless, the Court struck down the assignment. The case was followed, as was *Constance,* by a considerable amount of critical literature and resulted in "corrective" legislation being passed by Congress and many of the states. The legislation adopted by Congress in 1950 by Act of March 18, 64 Stat. 24, eliminated the *bona fide* purchaser test and substituted the test contained in §60a (3), of when the transaction became perfected as against a hypothetical, simple contract creditor with a lien obtained by legal or equitable proceedings, "whether or not there are or were creditors who might have obtained such liens." The language was deliberately made similar to that of §70c. The similarity cannot be disregarded.

The criticisms of *Constance* are an echo of a long forgotten idea that an assignee for the benefit of creditors stands in the shoes of his assignor and has no better position than that of existing creditors. The Bankruptcy Act does not so limit the Trustee's powers but gives him certain superadded statutorily derived powers which are wholly

independent of the powers of the bankrupt or of his existing creditors.

These powers are the powers of the most favored class of creditors—whether or not there is an existing member of that class. They are the powers of the ideal hypothetical creditor—whether or not such a creditor actually exists. They are the powers of a creditor with a lien, and included in these powers are the powers of the ideal hypothetical creditor without a lien who has extended credit in the interim between the execution and recording of a tardily recorded chattel mortgage.

CONCLUSION

The judgment of the 6th Circuit should be reversed, and the mortgage of the respondent should be held void as against petitioner under §70c of the Bankruptcy Act.

Respectfully submitted,

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